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IN THE

Supreme Court of the United States

OCTOBER TERM, 1952

No. ~~716~~ 37

In the Matter of

FLORIDA EAST COAST RAILWAY COMPANY,
Debtor.

W. G. WELBON, E. N. CLAUGHTON, and A. W. CORBETT,
Petitioners,

vs.

ATLANTIC COAST LINE RAILROAD COMPANY,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT AND SUPPORTING BRIEF

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

To the Honorable Fred M. Vinson, Chief Justice of the United States, and the Associate Justices of the Supreme Court of the United States:

Petitioners, W. G. WELBON, E. N. CLAUGHTON and A. W. CORBETT, respectfully show:

I.

SUMMARY STATEMENT

Petitioners pray the issuance of a Writ of Certiorari to review the judgment of the United States Court of

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Appeals for the Fifth Circuit, two of five judges dissenting, in the appeal numbered and entitled on its docket 14163, *In the Matter of Florida East Coast Railway Company, Debtor—Atlantic Coast Line Railroad Company, Appellant, vs. St. Joe Paper Company et al, Appellees.* (II, 734)[1]

The record of said appeal, consisting of six volumes numbered I to VI, inclusive, is now before this Court upon Petition for Certiorari by St. Joe Paper Company et al., No. 670 October Term, 1952, except that said record does not include the matters evidenced by the following exhibits attached to and made a part hereof:

Exhibit A—Record of petitioners' Petition for Rehearing and order denying same.

Exhibit B—Record of opinions and judgment of said Court of Appeals in the 1949 appeal numbered and entitled on its docket 12821, *Atlantic Coast Line Railroad Company et al vs. St. Joe Paper Company, et al.*

The record in Certiorari No. 670 October Term, 1952, is made a part hereof by reference, and petitioners pray reference thereto in support of this petition.

The judgment sought to be reviewed reversed an order by Circuit Judge Strum, presiding in the United States District Court for the Southern District of Florida, Jacksonville Division. His order disapproved the Interstate Commerce Commission's fourth plan for the reorganization of debtor under § 77 of the Bankruptcy Act. The grounds of disapproval were that the plan is "neither fair nor equitable" and "does not afford due recognition to the rights of the 5% bondholders, *particularly the minority groups.*" (Emphasis supplied) Based on the disapproval and on a finding of "undue delay in a reasonably expeditious reorganization" of

1. This is a reference to page 734 in Volume II of the record in Certiorari No. 670 October Term, 1952. All references to that record will be made in the same manner.

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debtor, the order also dismissed the § 77 proceeding. (I, 168-170)

Without making the findings required by § 77(e),[2] the Court of Appeals directed Judge Strum to approve the plan. (II, 734)

Petitioners comprise one of the minority bondholder groups. They are holders of debtor's 5% First and Refunding Bonds, the senior class of securities that would not be paid in full. The principal of the issue is $45,000,000. Interest presently in default amounts to $37,125,000. The total principal and interest is $82,125,000.

St. Joe Paper Company and affiliated interests own a majority of the bonds. They frequently are referred to collectively as the majority bondholder.

The questions presented grow out of the forced sale which would result from enforcement of the so-called "forced merger" provisions of the third and fourth plans. The provisions are that all of debtor's business, assets, franchises and property shall be "vested" in Respondent, Atlantic Coast Line Railroad Company, free and clear of all of debtor's indebtedness and discharged from the lien of the 5% mortgage, by merger

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2. "* * * the judge shall approve the plan if satisfied that: (1) It complies with the provisions of subsection (b) of this section, is fair and equitable, affords due recognition to the rights of each class of creditors and stockholders, does not discriminate unfairly in favor of any class of creditors or stockholders, and will conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders; (2) the approximate amounts to be paid by the debtor, or by any corporation or corporations acquiring the debtor's assets, for expenses and fees incident to the reorganization, have been fully disclosed so far as they can be ascertained at the date of such hearing, are reasonable, are within such maximum limits as are fixed by the Commission, and are within such maximum limits to be subject to the approval of the judge; (3) the plan provides for the payment of all costs of administration and all other allowances made or to be made by the judge, except that allowances provided for in subsection (c), paragraph (12) of this section, may be paid in securities provided for in the plan if those entitled thereto will accept such payment, and the judge is hereby given power to approve the same."

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of debtor into or its consolidation with or transfer and conveyance of its property to Coast Line, and that the 5% bondholders shall be compelled to accept unwanted Coast Line securities ($42,500,000 par and stated value) and a modicum of cash ($4,000,000) in extinguishment of their present equitable ownership of debtor. (282 ICC 213-226; I, 213-226; 267 ICC 748-759; IV, 748-759)

Those provisions have been consistently opposed before the Commission and in the courts on behalf of the holders of overwhelming majorities in amount of the 5% bonds. They are not supported by any bondholder. (267 ICC 295-391; IV, 295-391; 267 ICC 729-747; IV 729-747; 81 F Supp 926; V, 466-481; 179 F2d 538; Exhibit B, 1-22; 282 ICC 81-191; I, 81-191; 282 ICC 195-212; I, 195-212; 103 F Supp 825; I, 127-168; 201 F2d 325; II, 717-733)

Coast Line is the only proponent of the plan. It is one of debtor's three connecting carriers. It is not being reorganized under § 77 or otherwise, is not affiliated with debtor in any way, and has never controlled or had any proprietary interest in debtor. The two railroads have never been commonly owned or controlled. There has never been any interlocking, overlapping or integration of their financial structures. They have been completely independent of each other, their only relationship having been that of connecting carriers. (Record references in immediately preceding paragraph)

During the pendency of the reorganization proceeding Coast Line purchased unsecured claims against debtor aggregating $1,900,000 which the Commission had found to be without value. It paid $5,000 for the claims and agreed with the former owners to pay an additional 50% of whatever might be realized on them, less expenses. Until it bought the unsecured claims, Coast Line never had any financial interest in debtor, and was not even a creditor. (VI, 920-921; IV, 144-146; also record references in second preceding paragraph)

Coast Line's initial appearance in the proceeding came after Judge Strum had disapproved the Commis-

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ion's first plan[3] and hearings before the Commission on second plan had been closed. The appearance took the orm of a petition by a bondholder group to have the roceeding reopened for the submission of a plan under vhich Coast Line would acquire control of the reorgan-zed debtor by a forced sale to Coast Line of 60% of the ew common stock. The Commission unanimously re-ected this proposal[4] and approved a second plan provid-ng for full payment of the 4½% first mortgage bonds ut of surplus cash, the setting aside of $8,700,000 re-erves for betterments and improvements and cash equirements upon reorganization, and the receipt by he 5% bondholders, for each $1,000 bond, of $450 new rst mortgage income bonds and 4½ shares of common tock. (261 ICC 187-193; IV, 187-193; 261 ICC 170-187; V, 170-187)

On petitions for modification the Commission re-pened the proceeding and Coast Line proposed the forced merger" plan. (267 ICC 295-298; IV, 295-298)

3. The plan provided that the 4½% first mortgage bondholders ould receive new first mortgage bonds equal in amount and seniority the bonds then held, and the 5% bondholders should receive, for ch $1,000 bond, $100 of new general mortgage bonds and 10 shares f no par value stock. (252 ICC 423; VI, 528; 252 ICC 731; VI, 641) was disapproved solely on the ground that it should have allocated for organization purposes, instead of leaving as a floating surplus, approxi-ately $17,000,000 in cash or its equivalent which had accumulated in e hands of the trustees. (52 F Supp 420; VI, 690-697)

4. For the reasons that the fixed charges proposed for debtor and oast Line might, during a depression of any considerable duration, con-ibute toward precipitating bankruptcy proceedings for both carriers; e securities proposed, taken at par, would fall far short of satisfying the mount of the claim of the 5% bondholders and if, in their view, the rospects of future earnings or the control value were such that the stock ight later have a market value in excess of par and they desired to hold to realize the higher price, they should be at liberty to do so, as they ould not be reimbursed in full on their claim by accepting $100 per are for stock representing a part of their share of debtor's estate; the ajority bondholder would vote to reject the proposal; the § 77 power order a judicial sale of the property of debtor for the benefit of cred-ors did not confer power "to sell the interests of one or all the creditors another creditor or to an outsider for the benefit of the purchaser"; nd the proposal was prima facie impracticable. (261 ICC 187-193; V, 187-193)

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After lengthy hearings, the Examiner's full and carefully considered report recommended strongly that the second plan be modified in relatively minor respects and otherwise be adhered to.[5] (VI, 734-848)

By a five to four vote the Commission overruled the Examiner and approved Coast Line's forced merger plan, with modifications, as the Commission's third plan. (267 ICC 390-391; IV, 390-391) The approving report refused to permit a judicial sale of debtor's property. The reason given was that it would defeat the proposed transfer, "since Coast Line obviously could not compete successfully in bidding with the debtor's first and refunding bondholders." (267 ICC 307; IV, 307)

Approval of the plan was based on findings, with strong dissents,[6] that the vesting of debtor's property

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5. The Examiner saw and heard the witnesses and was better able than the Commission to evaluate the evidence. He said: " * * * the Commission should find that a merger of the debtor with the Coast Line would result in no appreciable improvement in transportation service to the public as compared with such service under independent operation; that the eventual savings from such merger would not be such as to warrant consideration of them as a controlling factor and would be realized only by having an immediately adverse effect upon the city of St. Augustine, Fla. and surrounding territory; that the predominant sentiment of residents, shippers and communities on the east coast of Florida in the territory served by the debtor is in favor of independent operation of the debtor; that a merger of the debtor with the Coast Line is not necessary to assure the future financial stability of the debtor, or continued adequate, economical and efficient service and that the nature of the holdings, management and affiliations of the St. Joe Company is not such as to preclude it as a proper party to control the debtor's property.

"For these reasons the Commission should find and conclude that a plan of reorganization of the debtor which shall vest control of the reorganized company in the first and refunding mortgage bondholders, with resulting control in the St. Joe Company, will, with provisions for proper recognition of the rights of minority interests after reorganization, be compatible with the public interest." (VI, 790-791)

6. In Commissioner Mahaffie's first dissent (267 ICC 390; IV, 390), in which four other Commissioners joined, some initially, others later (267 ICC 747; IV, 747), he said: "Aside from what seems to me a fatal legal defect in the report, I think it wrong on the merits. The prin-

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in Coast Line would result in operating economies, but reorganization by the 5% bondholders would result in control of the reorganized debtor by the majority bondholder, and "While no violation of the letter or the spirit of the so-called commodities clause of the Interstate Commerce Act would necessarily result through St. Joe Company control of the reorganized debtor, nevertheless the Du Pont estate will be in a position, particularly because of its large banking interests, to influence a great number of shippers to route their shipments over any connecting carrier which, because of advantageous division arrangements or for other reasons of its own, it may wish to favor." Also, "that such opportunity given to a private institution of admittedly widespread power, presents a situation which might have grave consequences and against which it would be impossible adequately to protect the shipping public and the carriers with which the debtor's line connects * * *." (267 ICC 346; IV, 346)

Upon reconsideration by the full Commission the plan was adhered to by a six to five vote. (267 ICC 729-747; IV, 729-747)

The plan was objected to in the District Court on behalf of holders of more than 98% in amount of the 5% bonds. (81 F Supp 932; V, 476; 179 F2d 542; Exhibit B, 7) It was disapproved by Circuit Judge Sibley, presiding as judge designate. (81 F Supp 926; V, 466) His grounds were that § 77 does not authorize a plan

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cipal controversy before us is whether the public interest will be best served by making this property a part of the Atlantic Coast Line system or by permitting it to remain independent of railroad control. On that issue much testimony was taken. Extensive briefs were filed and argument lasting two days was heard. The majority decide the issue in favor of the Atlantic Coast Line. I submit that the great preponderance of the pertinent testimony is to the contrary. The views of the persons served by the railroad, the persons dependent on it for a livelihood, and of those who own its securities all have to be very largely disregarded in order to reach the majority conclusion. I would approve a plan which, in its main features, is substantially as proposed by the examiner. This would permit the property to be reorganized. The result of the present report, in my judgment, is more likely to be prolonged litigation." (267 ICC 391; IV, 391)

providing for "a forced merger of debtor with Coast Line" (81 F Supp 932; V, 476), but if it does, and is within constitutional bankruptcy power, the plan was not fair and equitable and did not afford due recognition to the rights of the bondholders.

He also decided that the minority bondholders had "done nothing amiss," and the plan was "unfair, inequitable, and not a due recognition of their rights," because the findings regarding control by the majority bondholder in a bondholder reorganization did not justify the requirement that the minority bondholders "must surrender the investment they have chosen and lawfully own in the East Coast property and must take in return an investment which most of them do not desire to own and do not think is an equivalent." (81 F Supp 933-934; V, 478-481)

The Court of Appeals affirmed, one of three judges dissenting. (179 F2d 538; Exhibit B, 1-22) This Court denied certiorari. (339 US 929) However, two judges in the Court of Appeals thought Judge Sibley was wrong on the question of forced merger and agreed that § 77 authorizes a plan providing for a forced merger over the objections of the 5% bondholders. No reference was made by either judge to petitioners' contention that, so construed, § 77 violates the due process and eminent domain clauses in the Fifth Amendment.[7]

Because petitioners prevailed in the Court of Appeals, review of the adverse ruling on the forced merger question was not open to them, and the Commission and the courts have regarded the ruling as the law of the case in all subsequent proceedings. Nevertheless, petitioners have consistently advanced the contention that § 77 does not authorize a forced sale of debtor's property to Coast Line over the objections of the 5%

7. The fourth point argued in petitioners' brief was: "If § 77 authorizes the proposed expropriation, the section itself is not within but exceeds the bankruptcy power of Congress, is not a valid exercise of the power, and violates the due process and eminent domain clauses in the Fifth Amendment."

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bondholders, but if it does, it violates the due process and eminent domain clauses in the Fifth Amendment. (I, 20, 17th objection — 44, 4th objection; Exhibit A, 3rd and 4th grounds of Petition for Rehearing)

Coast Line proposed another forced merger plan. With modifications, it was approved by a seven to three vote as the Commission's fourth plan. (282 ICC 81-191; I, 81-191) Petitioners' petition for modification was denied by a seven to three vote. (282 ICC 195-212; I, 195-212)

The fourth plan was objected to in the District Court on behalf of holders of more than 99% in amount of the 5% bonds. (103 F Supp 833; I, 138) Judge Strum thought he was bound by the law of the case that § 77 authorizes a forced merger with Coast Line (103 F Supp 834; I, 140), but in disapproving the plan as unfair, inequitable and not a due recognition of the rights of the 5% bondholders, he found that "One of the outstanding infirmities of the fourth plan, as it was also of the third, is its adverse impact upon the rights of the minority 5% bondholders." (103 F Supp 834; I, 141)

His exhaustive opinion analyzed and discussed the plan, proceedings and evidence. He demonstrated that the findings regarding the majority bondholder were mere speculations, wholly unsupported by any evidence, but, if the evidence had supported them, they could not equitably serve as a basis for penalizing the minority bondholders in the manner attempted by the plan.[8]

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8. "* * * the Commission is still preoccupied with, and completely immersed in, this struggle for control between A.C.L. and the duPont interests, in which it has favored the Coast Line with adamant consistency since 1947, and to the distinct prejudice of the $20,000,000 of minority 5% bondholders, who, in order to effect a merger with the Coast Line, are required to relinquish what they now lawfully own and desire to keep, and to become involuntary security holders in Atlantic Coast Line, a wholly unrelated corporation. This result is unfair to all the 5% bondholders, but particularly to the minority groups, who are innocent bystanders caught between the upper and nether millstone, and who now,

The controlling opinion in the Court of Appeals indicates that no consideration was given to the rights and equities of the minority bondholders, as distinguished from those of the majority bondholder. (201 F2d 325-331; II, 717-731) Neither does it refer to petitioners' contention that if § 77 authorizes the forced merger, the section violates the due process and eminent domain clauses in the Fifth Amendment. The material parts of the opinion are largely a series of dogmatic assertions that the commission majority's findings are supported by evidence and Judge Strum's are not, and that the commission majority was right and Judge Strum was wrong. In effect, it holds that Judge Strum had no power to exercise an "informed, independent judgment" on the questions whether the plan is fair and equitable, affords due recognition to the rights of the 5% bondholders, discriminates unfairly in favor of Coast Line as an unsecured creditor, and conforms to the requirements of the law of the land regarding the participation of the minority bondholders. In an attempt to fortify the dogmatic conclusions previously stated, and far in advance of the event, it also holds that after the anticipated rejecting vote of the bondholders, the plan must be confirmed unless "conditions

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like ancient Odysseus, drift helplessly between Scylla and Charybdis, hoping to be rescued." (103 F Supp 835; I, 141)

" * * * the Commission had before it a plan proposed by the duPont interests under which the duPonts agreed to accept all common stock in a reorganized company in lieu of their present $25,000,000 of 5% bonds, giving to all other bondholders new 4% fixed interest first mortgage bonds, which would be worth par, on a dollar for dollar of principal basis of exchange. Thus, the minority 5% bondholders would receive more and better bonds than under the Coast Line plan, and would be assured of a good return on a sound investment, while the duPont interests would take all the chances as to earnings. The minority 5% bondholders enthusiastically favored and urged this plan. But the Commission rejected it in favor of the Coast Line plan, under which these bondholders would receive less, because the Commission found that the public interest required operation and control of F.E.C. by A.C.L." (103 F Supp 842; I, 156)

"It should here be mentioned again that there are $20,000,000 of minority 5% bondholders who do not own any Florida banks, but who will nevertheless be penalized by the Commission's apprehensions as to the public interest." (103 F Supp 845; I, 164)

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should so change" as to render it no longer "fair and reasonable."

The minority opinion by Judge Russell, with whom Judge Borah joined, agreed with Judge Strum that the plan provided for "an enforced, noncompetitive sale of F.E.C. to A.C.L., a wholly unrelated corporation, over the objections of 99% of the present bondholders, whose property interests are at stake, and who do not wish to sell, and * * * virtually gives A.C.L. the power of eminent domain over F.E.C., with authority to pay, not in cash, but 90% in Coast Line securities of debatable value." (201 F2d 331; II, 731-733) It also agreed with Judge Sibley that the plan is not authorized by § 77, and pointed out that the majority holding "poses a serious constitutional question as to whether the court's power in bankruptcy could thus be extended to force a merger consistent with the Fifth Amendment."

Petitioner's petition for rehearing was the only one filed. Judges Russell and Borah dissented from its denial. (Exhibit A, 5)

II.

STATEMENT OF JURISDICTION

The jurisdiction of this Court is invoked under 28 USC § 1254(1), conferring on this Court jurisdiction to review the judgment of the Court of Appeals by writ of certiorari.

The judgment of the Court of Appeals was rendered January 19, 1953. (II, 734) The petition for rehearing was denied March 2, 1953. (Exhibit A, 5)

III.

QUESTIONS PRESENTED

1. Does § 77 of the Bankruptcy Act authorize the "forced merger" plan providing that debtor's property shall vest in Coast Line free and clear of debtor's indebtedness and discharged from the lien of the 5%

mortgage, and that the 5% bondholders, in extinguishment of their present equitable ownership of debtor, shall be compelled to accept unwanted Coast Line securities and nominal cash in an aggregate amount substantially less than the principal and interest of their bonds?

2. If § 77 authorizes the "forced merger" plan, does the section violate the due process and eminent domain clauses in the Fifth Amendment to the Constitution of the United States?

3. If § 77 authorizes the "forced merger" plan and is constitutional, are the findings regarding the majority bondholder a sufficient justification for depriving the minority bondholders of their present prorata equitable ownership of debtor? Does the deprivation afford due recognition to their rights and conform to the requirements of the law of the land regarding their participation?

4. If § 77 authorizes the "forced merger" plan and is constitutional, is the plan unfair, inequitable and not a due recognition of the rights of the 5% bondholders because one of its stated purposes is to preclude realizing the highest possible sale price for the bondholders' security and to limit the sale price to so-called reorganization value expressed in terms of securities of a wholly unrelated corporation?

5. If § 77 authorizes the "forced merger" plan and is constitutional, does the plan violate the absolute priority rule of the Boyd and later cases[9] by appropriating the 5% bondholders' security to the payment of Coast Line's unsecured claim?

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9. *Reconstruction Finance Corp.* v. *Denver & R G W R Co*, 328 US 495 (1946); *Ecker* v. *Western Pacific R Corp*, 318 US 448 (1943); *Institutional Investors* v. *Chicago M St P & P R Co*, 318 US 523 (1943); *Marine Harbor Properties* v. *Manufacturer's Trust Co*, 317 US 78 (1942); *Consolidated Rock Products Co* v. *DuBois*, 312 US 510 (1941); *Case* v. *Los Angeles Lbr Products Co*, 308 US 106 (1939); *Kansas City Terminal R Co* v. *Central Union Trust Co*, 271 US 445 (1926); *Northern Pacific R Co* v. *Boyd*, 228 US 482 (1913).

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6. Absent a clear abuse by Judge Strum of the informed discretion conferred by the term "if satisfied" in § 77(e), was the Court of Appeals justified in setting aside his findings that the plan is unfair, inequitable and not a due recognition of the rights of the minority bondholders?

IV.

REASONS RELIED ON FOR ALLOWANCE OF WRIT

1. By construing § 77 of the Bankruptcy Act as authorizing the so-called "forced merger" plan, the Court of Appeals decided an important question of federal law which has not been, but should be, settled by this Court.

2. The Court of Appeals so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision. The departures were: First, the failure of the Court of Appeals to decide petitioners' contention that § 77 of the Bankruptcy Act, as construed, violates the due process and eminent domain clauses in the Fifth Amendment; second, the failure of the Court of Appeals to give any consideration to the rights and equities of the minority bondholders, as distinguished from those of the majority bondholder.

3. The questions decided by the Court of Appeals are of paramount importance in the administration of reorganization proceedings under § 77 of the Bankruptcy Act, and have not been, but should be, settled by this Court.

4. The decision of the Court of Appeals that the fourth plan does not violate the absolute priority rule conflicts with principles enunciated by this Court in the Boyd and later cases.[10]

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10. Cases cited page 12, footnote 9.

BRIEF IN SUPPORT OF PETITION FOR CERTIORARI

I.

The Opinions of the Courts Below

The Court of Appeals opinions in connection with the judgment sought to be reviewed were handed down January 19, 1953 and are reported as *In re Florida East Coast Ry Co,* 201 F2d 325. They are in Volume II of the record, at pages 717-733.

Judge Strum's District Court opinion of March 11, 1952 in connection with his order disapproving the fourth plan of reorganization is reported as *In re Florida East Coast Ry Co,* 103 F Supp 825. It is in Volume I of the record, at pages 127-168.

Judge Strum's District Court opinion of October 19, 1943 disapproving the first plan of reorganization is reported as *In re Florida East Coast Ry Co,* 52 F Supp 420. It is in Volume VI of the record at pages 690-697.

Judge Sibley's District Court opinion of January 22, 1949 disapproving the third plan of reorganization is reported as *In re Florida East Coast Ry Co,* 81 F Supp 926. It is in Volume V of the record, at pages 466-481.

The Court of Appeals opinions of January 17, 1950 in connection with its judgment affirming Judge Sibley's disapproval of the third plan are reported as *Atlantic Coast Line R Co* v. *St. Joe Paper Co,* 179 F2d 538. They are in Exhibit B at pages 1-22.

II.

The Reports of the Interstate Commerce Commission

The Commission's report of April 6, 1942 approving the first plan of reorganization is reported as *Florida East Coast Ry Co Reorganization,* 252 ICC 423. It is in Volume VI of the record, at pages 528-640.

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The Commission's Supplemental Report of August 10, 1942 modifying the first plan of reorganization is reported as *Florida East Coast Ry Co Reorganization,* 252 ICC 731. It is in Volume VI of the record, at pages 641-689.

The Commission's Second Supplemental Report of January 8, 1945 approving the second plan of reorganization is reported as *Florida East Coast Ry Co Reorganization,* 261 ICC 151. It is in Volume IV of the record, at pages 151-194.

Examiner Jewell's Proposed Third Supplemental Report is in Volume VI of the record, at pages 734-848.

The Commission's Third Supplemental Report of April 8, 1947 approving the third plan of reorganization is reported as *Florida East Coast Ry Co Reorganization,* 267 ICC 295. It is in Volume IV of the record, at pages 295-391.

The Commission's Fourth Supplemental Report of March 25, 1948 adhering to the third plan of reorganization is reported as *Florida East Coast Ry Co Reorganization,* 267 ICC 729. It is in Volume IV of the record, at pages 729-759.

The Commission's Fifth Supplemental Report of July 12, 1951 approving the fourth plan of reorganization is reported as *Florida East Coast Ry Co Reorganization,* 282 ICC 81. It is in Volume I of the record, at pages 81-191.

The Commission's Sixth Supplemental Report of October 25, 1951 adhering to the fourth plan of reorganization is reported as *Florida East Coast Ry Co Reorganization,* 282 ICC 195. It is in Volume I of the record, at pages 195-226.

III.

Jurisdiction

Jurisdiction to review the judgment of the Court of

OPY

Appeals by writ of certiorari is conferred on this Court by 28 USC § 1254(1).

The judgment of the Court of Appeals was rendered January 19, 1953. (II, 734) Petitioners' petition for rehearing was denied March 2, 1953. (Exhibit A, 5)

IV.

Statement

The nature of the case and the decisions of the Court of Appeals for the Fifth Circuit are stated in the foregoing petition, pages 1-11, which, in the interest of brevity, is adopted as a part of this brief.

V.

Specifications of Error

The Court of Appeals erred in the following respects:

1. In deciding that § 77 of the Bankruptcy Act authorizes the so-called "forced merger" plan of reorganization.

2. In failing to decide petitioner's contention that § 77 of the Bankruptcy Act, as construed, violates the due process and eminent domain clauses in the Fifth Amendment.

3. In not deciding that the fourth plan is unfair, inequitable, and not a due recognition of the rights of the 5% bondholders, because one of its stated purposes is to preclude realizing the highest possible sale price for the bondholders' security and to limit the sale price to so-called reorganization value expressed in terms of securities of a wholly unrelated corporation.

4. In not deciding that the fourth plan violates the absolute priority rule of the Boyd and later cases by appropriating the 5% bondholders' security to the payment of Coast Line's unsecured claim.

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5. In setting aside Judge Strum's findings and directing approval of the plan, without making alternative findings and without considering the rights and equities of the minority bondholders, as distinguished from those of the majority bondholder.

6. In reversing Judge Strum's order disapproving the fourth plan.

VI.

Argument in Support of Reasons Relied on for Allowance of Writ

Reason 1

By construing § 77 of the Bankruptcy Act as authorizing the so-called "forced merger" plan, the Court of Appeals decided an important question of federal law which has not been, but should be, settled by this Court.

It is believed that this is the only reorganization proceeding in which an attempt has been made to utilize § 77 to force the transfer of a debtor's property to an unaffiliated, wholly unrelated railroad, which is not being reorganized under § 77 or otherwise, and to compel the senior claimants to accept the other railroad's securities in extinguishment of their equitable ownership of the debtor. No decision of this Court has dealt with such a proposal.

The resulting questions of law are novel. There is a dearth of pertinent authority. Both the Commission and the Court of Appeals divided sharply. The two circuit judges who presided in the District Court disagreed with the controlling opinions in the Court of Appeals. Of the seven circuit judges who presided in the District Court or the Court of Appeals, Judges Sibley, Strum,[11] Russell and Borah disagreed with the result, but by the accident of their assignments to preside the views of

11. These two saw and heard the witnesses and were better able than the others to evaluate the evidence.

Judges Hutcheson, Holmes and Rives prevailed. This extraordinary conflict of opinion emphasizes the need for decision of the questions by this Court.

The findings of the Commission majorities and the controlling opinions in the Court of Appeals were made to turn on the provisions in § 77(b) that a plan of reorganization "shall provide adequate means for the execution of the plan, which may include the transfer of any interest in or control of all or any part of the property of the debtor to another corporation or corporations, the merger or consolidation of the debtor with another corporation or corporations * * * ."

Petitioners contend that these provisions cannot be considered in splendid isolation, but should be construed in pari materia with all other provisions of § 77, and when so construed, it is evident that the quoted provisions were merely intended to preserve and authorize the established equity device of organizing a corporation or corporations as a means for the execution of a plan. In support of that construction they point to the § 77(f) provisions that upon confirmation of the plan "the debtor and any other corporation or corporations *organized or to be organized for the purpose of carrying out the plan,* shall have full power and authority to, and shall put into effect and carry out the plan." (Emphasis supplied)

Petitioners also urge that the legislative history of the Act clearly and explicitly confirms this construction, and the quoted provisions regarding "means for the execution" of a plan relate not to fair and equitable treatment of creditors but only to procedure for accomplishing what is determined to be fair and equitable.

Reason 2

The Court of Appeals so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision. The departures were: First, the failure of the Court of Appeals to decide petitioners' contention that § 77

of the Bankruptcy Act, as construed, violates the due process and eminent domain clauses in the Fifth Amendment; second, the failure of the Court of Appeals to give any consideration to the rights and equities of the minority bondholders, as distinguished from those of the majority bondholder.

Judge Sibley did not reach the constitutional question in disapproving the third plan. His decision that § 77 does not authorize a forced merger eliminated the constitutional question. (81 F Supp 926; V, 466-481) On appeal Judge Russell agreed with him (179 F2d 538; Exhibit B, 16), but Judges Hutcheson and Holmes agreed, in separate opinions (179 F2d 538; Exhibit B, 1-15; 179 F2d 545; Exhibit B, 16-22), that § 77 does authorize a forced merger. They did not notice nor decide the contention that, so construed, § 77 violates the Fifth Amendment.

Judge Strum did not reach the constitutional question in disapproving the fourth plan because he thought he was bound by the law of the case as agreed by Judges Hutcheson and Holmes. (103 F Supp 834; I, 140) On appeal the constitutional question was not noticed or decided in the controlling opinion (201 F2d 325; II, 717-731), but the minority opinion points out that the constitutional question is posed by the holding that § 77 authorizes a forced, noncompetitive sale of debtor's property to Coast Line. (201 F2d 331; II, 731-733)

As construed by the commission majorities and the controlling opinions in the Court of Appeals, § 77 attempts to extend the scope of the bankruptcy power[12] into the field of eminent domain. The plan provides for the taking of the bondholders' security by Coast Line—as much so and with identically the same effect as if Coast Line had proceeded directly under Rule 71A of the Federal Rules of Civil Procedure by bringing an action in the District Court to condemn debtor's property. The

12. Constitution, Article 1, §8: "The Congress shall have Power * * * To establish * * * uniform Laws on the subject of Bankruptcies throughout the United States * * *."

only differences are that in the condemnation action Coast Line would be required to pay cash representing the present fair value of the property, but the plan permits Coast Line to pay only so-called reorganization value expressed in terms of Coast Line securities. This is contrary to all existing concepts of due process and just compensation.

The bankruptcy power is not susceptible of final definition, its scope being the "subject of the relations between an insolvent or nonpaying or fraudulent debtor, and his creditors, extending to his or their relief."[13] Nevertheless, "The bankruptcy power, like all the other great substantive powers of Congress, is subject to the Fifth Amendment."[14]

This case is the first in which any section of the Bankruptcy Act has been construed as authorizing an unsecured creditor to appropriate the security underlying senior claims. Petitioners urge that the Fifth Amendment inhibits such an enlargement of the bankruptcy power. They submit that the proposed taking of their property by Coast Line, at a price which has never been determined to be its present fair value, for compensation which is not payable in cash, violates the inhibitions of the Fifth Amendment.

The Court of Appeals also failed to give any consideration to the rights and equities of the minority bondholders, as distinguished from those of the majority bondholder. Judges Sibley and Strum made the distinction clearly and explicitly—the former in disapproving the third plan, the latter in disapproving the fourth plan. Each decided that regardless of what might be said about the majority bondholder, the plan under consid-

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13. *In re Reiman*, DC NY, Fed Case No. 11,673; *Wright* v. *Union Central Life Ins Co*, 304 US 502 (1938); *United States* v. *Bekins*, 304 US 27 (1938); *Continental Illinois N B & T Co* v. *Chicago R I & P R Co*, 294 US 648 (1935); *Hanover Nat'l Bank* v. *Moyses*, 186 US 181 (1902).

14. *Louisville Joint Stock Land Bank* v. *Radford*, 295 US 555 (1935).

eration was unfair and inequitable to the minority bondholders, and not a due recognition of their rights. (81 F Supp 926; V, 466; 103 F Supp 825; I, 127)

Judge Strum disapproved the fourth plan "For the same cogent reasons given by Judge Sibley and by Chief Judge Hutcheson as to the third plan, namely, because the fourth plan, as did the third, unjustly and inequitably subordinates the rights of the 5% bondholders, *particularly the $20,000,000 of minority bonds,* to the accomplishment of a forced merger with Atlantic Coast Line." (103 F Supp 846; I, 164-165—Emphasis supplied)

The legal effect of Judge Strum's determination and findings in disapproving the plan for this and other reasons was completely ignored by the majority opinion in the Court of Appeals. Section 77(e) leaves this determination within the informed discretion of the District Court. It provides that he shall approve a plan only "if satisfied" that it meets the conditions therein set forth, including fairness and equity, and the due recognition of the rights of bondholders. Those words, "if satisfied," have appeared in various sections of the Bankruptcy Act at least since the Act of 1898 (see 11 USC § 30 re confirmation of composition). They have always been construed to invest in the District Judge a discretionary judicial function, which could only be reversed upon an appellate finding of a clear abuse of discretion.[15]

The majority in the Court of Appeals made no such finding. The majority merely decided that, considering the question de novo, they would have decided, and did decide, to the contrary. Nor, in doing so, did the majority itself make the findings required of the District Court

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15. *In re Youtie,* 44 F2d 56 (CA 3, 1930); *In re Pilsener Brewing Co,* 79 F2d 63, 68 (CA 9, 1935); *Scherck, Richter Co* v. *Dysart,* 123 F2d 364, 369 (CA 8, 1941). This Court has said that other sections requiring that the judge be "satisfied" before approving a plan call for the exercise of his "informed, independent judgment." *Case* v. *Los Angeles Lbr Products Co,* 308 US 106, 115 (1939); *Consolidated Rock Products Co* v. *DuBois,* 312 US 510, 520 (1941); *Kelley* v. *Everglades Drainage District,* 319 US 415, 418 (1943).

under § 77(e). They merely decided that a contrary result should be achieved.[16]

Petitioners urge that when the Court of Appeals ignored the question of unfairness to the minority bondholders, it was guilty of a departure from the accepted practices of judicial proceedings calling for the exercise of this Court's power of supervision.

Reason 3

The questions decided by the Court of Appeals are of paramount importance in the administration of reorganization proceedings under § 77 of the Bankruptcy Act, and have not been, but should be, settled by this Court.

A question of paramount importance in the administration of § 77 is whether the fourth plan is unfair, inequitable and not a due recognition of the rights of the 5% bondholders because one of its stated purposes is to preclude realizing the highest possible sale price for the bondholders' security and to limit the sale price to so-called reorganization value expressed in terms of securities of a wholly unrelated corporation.

The report approving the third plan refused to permit a judicial sale of debtor's property. The commission majority said: "In any plan purporting to transfer control of the debtor to the Coast Line, a provision permitting a judicial sale of the mortgaged property * * * would defeat such a transfer, since the Coast Line obviously could not successfully compete in bidding with the debtor's first and refunding bondholders." (267 ICC 307; IV, 307)

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16. Compare *Institutional Investors* v. *Chicago M St P & P R Co*, 318 US 523, 564 (1942): "We would have quite a different problem if the District Court had failed to perform the functions which §77(e) places upon it. * * * Our role on review is a limited one. It is not enough to reverse the District Court that we might have appraised the facts somewhat differently."

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The report adhering to the third plan says: "The valuation of $40,500,000 is not intended to represent worth of the property such as would be determined by an inventory of the physical assets. * * *Value for reorganization purposes, physical value, and market value, are each entirely different, and we concern ourselves only with the first. The requirement that the plan be fair and equitable is satisfied if the creditors of the debtor receive Coast Line securities which are the equitable equivalent of the securities which they would receive under an independent reorganization of the debtor."[17] (267 ICC 736; IV, 736)

The report approving the fourth plan says nothing about a judicial sale, but the plan does not provide for one. (282 ICC 81; I, 81; 282 ICC 213; I, 213) The report does say: "We conclude that the value of debtor's property in terms of Coast Line securities, including one-half of the prospective savings, is $46,500,000, plus outstanding equipment obligations." (282 ICC 160; I, 160)

It thus appears that a stated purpose of the plan is to preclude realizing the highest possible sale price for the bondholders' security and to limit the sale price to so-called reorganization value expressed in terms of Coast Line securities.

The majority of the Court approves this wholly arbitrary purpose and its attitude is fully revealed by its action in attempting to pass upon a matter not before it and in advance of the event. It has condemned the bona-fide protests of the objecting bondholders as futile in an erroneous construction of the cramdown clause of §77(e). Thus the majority would disrupt the orderly

17. This paraphrases and misapplies the following statement in *Institutional Investors* v. *Chicago M St P & P R Co.* 318 US 523, 565 (1943): "It is sufficient that each security holder in the order of his priority receives from that which is available for the satisfaction of his claim the equitable equivalent of the rights surrendered." That was said regarding a plan designed to rehabilitate the debtor by reducing existing indebtedness to bring it within ability to pay. The statement has no application to a plan forcing a sale of the security underlying senior claims in a manner avowedly designed to prevent realizing the highest possible sale price.

administration of the reorganization provisions of the Act by ordering the plan approved and confirmed at one sitting, and bolstering its arguments for approval with its preconceptions of the course which should be followed on confirmation.

Reason 4

The decision of the Court of Appeals that the fourth plan does not violate the absolute priority rule conflicts with principles enunciated by this Court in the Boyd and later cases.

The plan provides that the senior creditors' security will be transferred to an unsecured creditor, free and clear of the mortgage lien, for a consideration which is substantially less than the mortgage debt and is payable principally in the junior creditor's stocks and bonds.

The junior creditor wants and will get the senior creditors' security. The senior creditors do not want but will be forced to accept the junior creditor's stocks and bonds.

Judge Strum decided that the plan violates the absolute priority rule of the Boyd and later cases.[18] (103 F Supp 842; I, 156-157) Petitioners urge that he was right.

The *Denver* case says[19] that "junior claims can receive nothing until the senior claims receive securities of a worth or value *equal to their indebtedness.*" (Emphasis supplied) The *Ecker* case says[20] the rule requires

18. *Reconstruction Finance Corp* v. *Denver & R G W R Co*, 328 US 495 (1946); *Ecker* v. *Western Pacific R Corp*, 318 US 448 (1943); *Institutional Investors* v. *Chicago M St P & P R Co*, 318 US 523 (1942); *Marine Harbor Properties* v. *Manufacturer's Trust Co*, 317 US 78 (1942); *Consolidated Rock Products Co v. DuBois*, 312 US 510 (1941); *Case* v. *Los Angeles Lbr Products Co*, 308 US 106 (1939); *Kansas City Terminal R Co* v. *Central Union Trust Co*, 271 US 445 (1926); *Northern Pacific R Co* v. *Boyd*, 228 US 482 (1913).

19. *Reconstruction Finance Corp* v. *Denver & R G W R Co*, 328 US 495, 517 (1946).

20. *Ecker* v. *Western Pacific R Corp*, 318 US 448, 483 (1943).

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that "senior claims first receive securities of a worth *sufficient to cover their face and interest* before junior claims receive anything." (Emphasis supplied)

Here the senior claims will not receive securities sufficient to cover their face and interest, nor of a worth or value equal to their indebtedness. Nevertheless, the junior claim will receive all of debtor's property.

Petitioners submit that if this can be done, it can be "only under the composition theory of reorganization," but that § 77, like Chapter X, rejected the composition theory "in favor of the full priority rule of the Boyd case. * * * That rule protects the rights of senior creditors against dilution either by junior creditors or by equity interests."[21]

Conclusive evidence of this congressional intent is found in the 1952 Amendments to the Bankruptcy Act. Congress wrote the full priority rule *out* of the "composition" sections of the Act (Chapters XI, XII and XIII), but *retained* it in the reorganization provisions.[22]

All of which is respectfully submitted.

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21. *Marine Harbor Properties* v. *Manufacturer's Trust Co.* 317 US 78, 86-87 (1942).

22. "The proposed amendment is designed to remove the fair and equitable provision, and by the paragraph added to each of the amended sections it is made clear that the rule of the Boyd and Los Angeles cases shall not be operative under those three chapters." Senate Report No. 1395 and House Report No. 2320, 82nd Congress, 2nd Session, paragraph No. 43 in each report.

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